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In the Supreme Court of the United States.

OCTOBER TERM, 1934

No. 537

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

v.

INTER-MOUNTAIN LIFE INSURANCE COMPANY.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

BRIEF FOR RESPONDENT IN OPPOSITION

OPINION BELOW

The Board of Tax Appeals rendered no formal opinion, but on the facts as stipulated (R. 10-29) held that the reserves here in question were reserves required by law within the meaning of the tax act. (R. 30.) The opinion of the Circuit Court of Appeals for the Tenth Circuit is reported in 71 Fed. (2d) 962.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 25, 1934 (R. 41). On motion of petitioner the time within which to file petition for writ of certiorari was extended sixty days. (R. 42.) The jurisdiction of this Court depends upon Section 240 (a) of the Judicial Code, as amended by the act of February 13, 1925.

QUESTION PRESENTED

Are reserves required by law to be maintained on account of portions of the valuation of coupon life insurance policies, being represented by such coupons, reserves required by law within the meaning of the 1921 Tax Act.

STATUTE AND REGULATIONS INVOLVED

Section 245 (a) (2) of c. 136, 42 Stat. 227, 261, and Article 681 of Treasury Regulations 62, as quoted in the Appendix to the petition at pages 11-13.

STATEMENT

The facts material to the present question, as shown by the stipulation of facts (R. 10-29), briefly stated, are as follows:

Respondent made and sold level premium 20-Payment Life Coupon Policies—Non-Participating, during the year 1922 and prior in the states of Utah, Idaho and Arizona (R. 11, 14). These policies contained the following provisions:

If all the premiums on the policy are paid in cash when due and at the end of twenty years the policy and all coupons attached thereto are delivered to the company, it will merge into a full paid life policy for $14,130.00, subject to satisfactory evidence of the insurability of the insured at that time (Guaranteed Option 2); or, without medical re-examination, into a full paid life policy for $10,000.00, with an annuity of $174.40 for the life of the insured (Guaranteed Option 4); or a full paid contract for an annuity of $490.00 for at least twenty years, and as long thereafter as the insured may survive (Guaranteed Option 3); or, at the insured's option, the company will pay him $8,000.00 (Guaranteed Option 1) (R. 15). Further, if all premiums are paid in cash when due and no matured coupons have been previously surrendered to the company, at the end of fifteen years, the policy

will merge into a full paid life policy for $10,000.00 (R. 16). The policy carried nineteen coupons, maturing on the respective anniversaries of the policy (R. 21-22). Matured coupons could be surrendered for paid up additions to the policy, reconvertible at any time into the cash value thereof (R. 22).

On January 1, 1922, the reserve maintained by respondent on account of its policy obligations represented by unsurrendered matured coupons was $126,949.03, and on December 31st of that year $146,097.75 (R. 12). Four per cent (4%) of the mean thereof amounted to $5,460.94. The Commissioner did not allow this amount as a deduction from gross income, but in lieu thereof allowed interest paid on coupons surrendered during the year amounting to $897.58 (R. 13).

ARGUMENT

From the above statement it will be seen that if respondent is entitled to the reserve deduction of $5,460.94, it is not entitled to the interest deduction of $897.58, as allowed by the Commissioner. Thus the amount of tax involved herein is the tax at the 1922 rate of 12½% on the difference between these amounts, or $570.42.

In *Continental Assurance Company* v. *United States*, referred to in the petition, the Court of Claims states that the amount of tax involved on the question at issue here was $698.81.

From the amounts involved in these two cases it can be seen that the question here at issue is comparatively insignificant and inconsequential and, therefore, is of no great public interest or concern.

The petition alleges a conflict in the decisions of these two cases, but when the contract at issue here is analyzed and compared with the court's analysis of the insurance contracts in the *Continental* case, on account of the differences in these contracts, no par-

ticular conflict is apparent. Consequently, considering the analysis of the insurance contracts in these cases by the lower courts, it is entirely probable that the two decisions will stand side by side in complete harmony and consistency.

The statutes of Utah, Idaho and Arizona, where the respondent was transacting business during the year 1922, provided for the annual valuation of all outstanding life policies by the insurance authorities thereof and the maintenance of a net value reserve equal to such valuation, which formed the reinsurance basis for such policies.

In *Great Southern Life Insurance Company* v. *Jones*, 35 Fed. (2d) 122, the Circuit Court of Appeals held:

> "But as only one premium was charged as a consideration for all the obligations assumed by the insurer, we think the policy constitutes but one agreement and must be considered as a whole."

This is a familiar rule applicable to the computation of net value reserves for the largest insurance liability assumed by the contract. This was recognized in *Standard Life Insurance Co. of America* v. *Commissioner*, 13 B. T. A. 13, 29, where it is held that:

> "It is further submitted that, where a variety of options is granted the policyholder, the contingency which would be the most costly to the company is the obligation which should determine the proper reserve."

Consequently, here, the net value reserve must be determined for a full paid policy at the end of twenty years in the amount of $14,130.00, if at that time the insured possesses a satisfactory degree of insurability, or, if not, in lieu thereof, without medical examination, a full paid policy for $10,000.00, with an annuity of $174.40 for the life of the insured. Certainly it must be admitted that in arriving at such results, under

the terms of the original policy, the value of the matured coupons attached thereto must have received full consideration. Therefore, it is submitted that the entire reserve maintained for such a policy must have been the usual net value reserve, paid for basis, as mathematically and actuarially computed. In this view of the case, the coupons seem to constitute a clever and ingenious device which enabled the insured to withdraw from the entire reserve maintained for the policy as a whole the surrender value of matured coupons whenever his necessities might require without in any manner impairing the remainder of his insurance benefits under the policy. This may explain why some companies previously included the entire reserve for their coupon policies in the net value reserve, paid for basis, while others reported the portion of their reserves relating to coupon values elsewhere in the liability schedule of their annual statements.

In this connection, it is interesting to note that the opinion of the Board of Tax Appeals in *Standard Life Insurance Co. of America, supra* (at page 26) quotes a resolution adopted by the National Convention of Insurance Commissioners in 1927, regarding the reporting of the reserve for coupon life policies, as follows:

> "There has been some lack of uniformity among some companies which write so-called 'coupon policies' in the manner of reporting matured coupons which are not cashed by the policyholder as they become due but are permitted to accumulate and remain with the company to apply to the reduction of the premium paying period, the purchase of additional insurance, or some similar guaranteed policy benefit. The proceeds of such matured coupons are, clearly, held by such companies to meet guaranteed policy obligations at maturity. They are therefore reserves required by law and should be included in the reserves of the company reported above Line Seven on the Convention blank."

This resolution shows that the opinion of the insurance authorities of the various states is that reserves for these coupon life policies are a part of the net value reserve, paid for basis.

Since the decision of the Board of Tax Appeals in the *Standard Life case supra,* affirmed by the Circuit Court of Appeals in 47 Fed. (2d) 218, Congress has had the revenue laws of 1932 and 1934 under consideration and has made no change in the basis for the deduction from gross income on account of reserve funds, although in the 1934 Act it did provide that in certain cases the rate for the computation of such deduction should be reduced. Therefore, it must be assumed that Congress thereby accepted and ratified the decision of the Board of Tax Appeals, as affirmed in *Commissioner* v. *Standard Life Insurance Co. of America, supra,* and the subsequent court decisions prior to the 1934 Revenue Act, as to the reserves to be used as the basis for the computation of this reserve deduction.

The court's attention is especially invited to the cases of *Commissioner* v. *Standard Life Insurance Company of America, supra; Commissioner* v. *Western Union Life Insurance Company,* 61 Fed. (2d) 207, *Commissioner* v. *Great American Life Insurance Company,* 70 Fed. (2d) 133, including the action of the court in denying petitioner's motion for rehearing, in the consideration of the petition herein.

CONCLUSION

In consideration of the foregoing, it is respectfully submitted that the petition herein should be denied.

Respectfully submitted,

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